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ABSTRACT

This paper makes the case that it is time for a renewal of the federal commitment to educational access. While the federal government is only one of several critical partners in the higher education finance system in the United States, it is the only entity with either the mission or the capacity to take responsibility for the national agenda of removing the financial barriers to higher education. The problem of unequal educational opportunities will not be solved by expecting individuals, private organizations, educational institutions, or state governments to set aside their own interests in order to further social goals. The solution will involve understanding market forces and the role of incentives and designing federal policies to harness those forces. The federal government is responsible for setting its own agenda and pursuing it, while providing incentives that will increase the level of participation of other entities in assuring access to postsecondary education for all qualified students. The need for increased funding for need-based grants at all levels should not be underemphasized, but encouraging the federal government to find efficient ways to target existing funds and generate new funds for educational opportunity from nongovernmental sources provides a more promising policy agenda in the short run. The paper lists an agenda of constructive steps toward strengthening the federal role in the student aid partnership. (Contains 13 references.) (SLD)

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The Financial Aid Partnership: Strengthening the Federal Government's Leadership Role

Sandy Baum

Research Report #3

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The College Board
National Dialogue On Student Financial Aid

PATHWAYS to COLLEGE NETWORK

Research Report 3

JANUARY 2003

THE FINANCIAL AID PARTNERSHIP: STRENGTHENING THE FEDERAL GOVERNMENT'S LEADERSHIP ROLE

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It is time for a renewal of the federal commitment to educational access. The federal government is only one of several critical partners in the higher education finance system in the United States, but it is the only entity with either the mission or the capacity to take responsibility for the national agenda of removing the financial barriers to higher education. The system relies on students and their families to make a significant contribution to the cost of education, supported by sizeable subsidies from federal and state governments, colleges and universities, and private organizations in both the for-profit and nonprofit sectors. In recent years, participants in this process have focused increasingly on making college more affordable for middle-income students, rather than on the fundamental goal of making postsecondary education accessible to all qualified students. The vital social policy agenda of improving this strong but complex and imperfect partnership will require a combination of well-targeted federal funding, added incentives for all partners to increase their subsidies to low-income students, and revitalization of the sense of public responsibility for ensuring educational opportunity.

THE PARTNERS

Despite the apparent relationship to the system's complexity, it is entirely appropriate that there are multiple participants, each with a different mission and a somewhat different interest in promoting access. From a national perspective, the goal is to encourage enrollment and persistence in appropriate educational institutions for all qualified students. Achieving this equity goal in an efficient manner requires that resources be directed at changing behavior in socially meaningful ways. In other words, we should focus on finding ways to ensure that our limited subsidy dollars have the maximum impact on educational choices that affect social welfare. While middle-income families and students do, in fact, struggle with educational costs, price changes are more likely to affect their choice of institutions than to determine whether or not they actually enroll and complete degrees. Low-income students, in contrast, make decisions about *whether* to go to college, not just about *where* to enroll. Federal polices designed to increase access are efficient if and only if they target those students whose behaviors they can significantly alter—students with very limited financial resources.

Like the federal government, state governments and higher education institutions are increasingly targeting subsidies at middle-income students who are *unwilling* to pay for particular schools, rather than at low-income students who are *unable* to pay for *any* postsecondary educational opportunities. These policies are inefficient and inequitable from a national perspective, but they may be quite reasonable from the perspective of the funding entities. In other words, the states and institutions are behaving in a manner that is not clearly inconsistent with their own goals.

State governments are responsible for creating an equitable society and an efficient economy within their own borders. It is hardly surprising that states are implementing grant programs designed to keep their best students in the state. These states are working on the assumption that students who go to college in the state are more likely to stay when they enter the labor market, contributing to the state's economy.[1] This may not be an efficient policy even at the state level, given the high cost of educating students and depending on how successful the policy is at decreasing long-term mobility, but it is consistent with the mission of the state governments.

1. A recent study suggests that marginal students who attend college in-state are between 8 percent and 10 percent more likely to reside in the state 16 years after graduation than those who leave the state for college (Groen and White, 2001).

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However, even if they are efficient for states, student aid policies designed to keep students close to home are not efficient from a national perspective. A student's decision to enroll in Georgia instead of Alabama does not constitute a meaningful change in behavior from the perspective of national social welfare.

Just as policies that are inefficient from a national perspective may appear to be efficient from a state perspective, equity may look quite different from the two arenas. A significant horizontal inequity arises from the different educational opportunities available to residents of different states, but for any state, it is only the opportunities available to their own citizens that are relevant. The federal government must change the incentive structure facing states if state funding patterns are to become more consistent with national goals.

In terms of dollars, state appropriation policies for institutions are much more important in affecting college access than are their student aid policies. Institutional subsidies are sensitive to cyclical economic forces, causing tuition to rise most rapidly during tight economic times, when students and families are least able to meet rising costs. If federal student aid policies provided adequate guarantees of need-based grant aid, this practice would shift the responsibility for access to the federal government, where it belongs. But given the inadequacy of federal funding, cyclical state funding creates cyclical access to higher education. In addition to providing more adequate aid dollars, federal policy should be designed to encourage states to allocate their funds more consistently over the business cycle.

Just as equitable and efficient state policies may be inconsistent with the national agenda, colleges and universities have goals that divert resources away from the national social welfare. Whether they are public or private, institutions must focus on attracting students who will improve their profiles, allowing them both to offer better educational experiences to their students and to attract more resources from the state, from private donors, and from students willing to pay the cost of attendance.

The student aid policies of both public and private colleges and universities have changed markedly since the federal government's interference a decade ago into the pricing and aid policies of private colleges. Currently, only those institutions that are wealthy enough to follow totally need-blind admissions policies are exempt from antitrust restrictions on coordinating their need-based aid policies. Congressional broadening of this exemption to allow all institutions to pursue policies designed to increase access for needy students might be an important step in reversing the trend towards non-need-based institutional aid.

Allowing students choice among institutions is an important part of policies designed to increase educational opportunity. In addition to the importance to individuals of being able to enroll in the most appropriate institutions, there may well be social benefits to reducing the stratification of higher education. However, in terms of the agenda of increasing access to college, a student's choice between two competing institutions that provide similar opportunities is not important. But if they are not allowed to cooperate to focus on access, colleges and universities can only compete for students, continuing their movement away from national equity and efficiency goals.

The business and nonprofit sectors have their own motivations for subsidizing students. Private businesses have an interest in nurturing a skilled labor force. This general interest is certainly compatible with national goals. However, it is reasonable to expect firms to award scholarships for particular fields of study. From the industry perspective, the policies may well be efficient whether or not these are fields where there is a significant national need. From the perspective of the goals of national student aid policy, however, this type of career change incentive is not efficient.

General social welfare is likely to be more central to the mission of most nonprofit foundations and other organizations devoting resources to subsidizing students. Even so, philanthropies will direct their funding towards students who fit their particular missions. In other words, while they are quite likely to make a positive contribution to educational opportunity for individual students, these private entities are unlikely to be the motivating force for a higher education funding system that has equity and opportunity for all students at its core.

The problem is not that states, institutions, or private entities are behaving irrationally, inefficiently, or inappropriately. It is the federal government's responsibility to shape incentive structures for its partners in the higher education financing system that will motivate states and institutions to choose to allocate their funds in a manner more consistent with national access goals. The federal government must also assure that national student aid policy sets the example and communicates a clear priority on assuring access to postsecondary education for all qualified students.

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Federal Successes

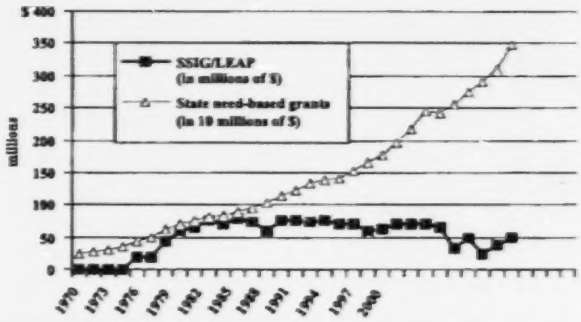
Concern over the direction of federal student aid policy is based on the long-term decline in the purchasing power of Pell Grants, the increasing dominance of loans in the federal aid package, and the introduction of education tax credits, which direct subsidies toward middle-income families, rather than toward low-income students. The perception of these trends is quite accurate. Between 1990 and 1997, Pell Grant funding increased by only 3.5 percent over the rate of inflation, while loans went from 48 percent to 60 percent of total student aid. In 1997, education tax credits, which provide a third of their benefits to taxpayers with incomes over $60,000, were introduced (College Board, 2002).

However, constructive criticism of the federal role in student aid finance must acknowledge the successes as well. Pell Grant funding has increased 43 percent in real terms since 1997. The change in the grant/loan ratio reflects a dramatic increase in the availability of loan funds as a result of the introduction of the unsubsidized Stafford Loan Program; the ratio of federal grant aid to subsidized loans fell only slightly, from 42 percent in 1991 to 40 percent in 2001. Despite its distributional problems, the tax credit program provides about $2 billion per year of subsidies to taxpayers with incomes below $40,000, most of whom require subsidies to make college a reality (College Board, 2002).

In addition to these core federal programs, the federal government has policies in place that effectively generate a considerable amount of nonfederal funding for low-income college students. Federal matching funds for state need-based grants currently generate about $80 million per year of state funds for the Leveraging Educational Opportunity Partnerships (LEAP). At the institutional level, federal matching funds for Supplemental Educational Opportunity Grants (SEOG), Perkins Loans, and Federal Work Study (FWS) provide the basis for over $500 million of institutional subsidies to students with financial need. Perhaps more dramatic is the fact that the federal guaranteed student loan program generates about $75 billion dollars per year in private loan funds for college students. In other words, the federal government plays a significant role in leveraging funds for students with documented financial need from other participants in the higher education funding process.

Since matching programs lower the price of aiding needy students, they are likely to increase state and institutional subsidies for these students. The federal policies may also have a significant impact beyond the direct impact of the dollars provided, as they increase consciousness of the need for targeted subsidies and the sense of public responsibility for those subsidies.

Figure 1.
State Need-Based Grant Funding and SSIG/LEAP



Source: National Association of State Student Grant and Aid Programs, *Annual Surveys, 1994–2000*; The College Board, *Trends in Student Aid, 1963-83, 1993, 2002*; National Center for Education Statistics, *Federal Support for Education, 1980 to 2001*.

It is, however, likely that modification of the existing level and structure of matching fund programs could increase their effectiveness. Growth in state need-based grant aid predates the SSIG program, and the grant aid has continued to grow at a relatively rapid rate over the past 20 years, even as SSIG/LEAP funding has stagnated and merit-based state grant programs have mushroomed (Figure 1). In other words, it is not clear how much incremental state funding can be attributed to the program. Research analyzing the impact of federal matching grants, both in terms of the direct incentive provided by matching funds and in terms of the reinforcement of the priority of increasing access to college for all qualified students, would strengthen policy efforts in this direction. Innovative approaches, such as providing incentives for enrolling Pell recipients—as proposed in the paper by McPherson and Schapiro accompanying this report—have the potential to motivate states and institutions to target more of their aid to low-income students.[2]

Federal Weaknesses

The federal government's success in generating state, institutional, and private funds for students provides a foundation for strengthening the efforts of all of these partners in increasing access to postsecondary education. But the inadequacy of funding for low-income students is certainly not the only weakness of the federal government's role in the student aid partnership. The Federal

2. Shireman (2002) makes a similar proposal to subsidize institutions for educating Pell Grant recipients.

Methodology (FM) for allocating need-based aid and some of the related rules and regulations limit the flexibility of institutions and other subsidizing entities to meet student need, as well as creating disincentives for work and saving on the part of students and their families.

The federal role in the allocation of need-based aid would be more equitable and more efficient if it were based on a simple formula, providing low-income students with a guaranteed level of grant aid adequate to cover the cost of education, when combined with a reasonable expected family contribution. This policy would also serve to strengthen interaction between federal subsidies for students and state subsidies, which are dominated by the indirect subsidies inherent in public college tuition levels. The federal government would meet its responsibility for assuring access to all qualified students more successfully if it awarded need-based grant aid generous enough for students to attend any public institution.

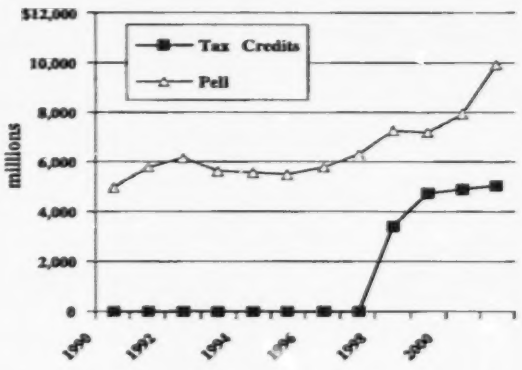
The Politics of Student Aid

Dollars directed towards middle- and upper-income students are dollars not available to low-income students. Still, the two types of funding sometimes grow together. While cause and effect are not clear, Pell Grant funding has increased much more rapidly in the years since the implementation of tax credits than in preceding years.

Nationally, state growth in need-based funding has not slowed as state merit aid programs have mushroomed. (See Figures 2 and 3.)

Figure 2.

Tax Credits and Growth in Pell Grants



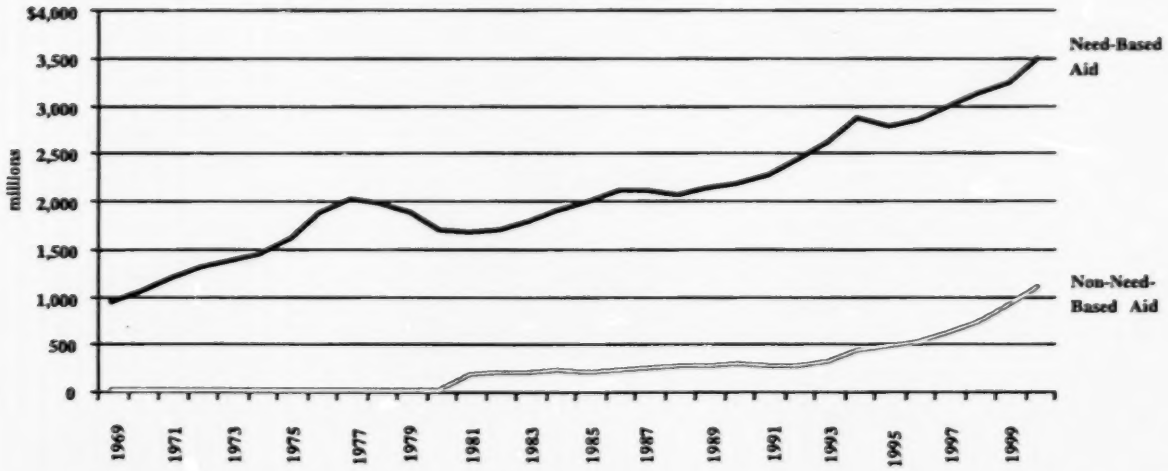
Source: Internal Revenue Service, *Statistics of Income, 1999*; College Board, *Trends in Student Aid, 2002*.

The reality is that subsidies to more affluent students, despite their clear shortcomings in terms of both equity and efficiency, can actually strengthen the commitment to all students. Low tuition levels at public colleges and universities make state support for higher education very important to the middle class, which does not view this part of the budget as an anti-poverty policy, but as the provision of a vital service to all citizens. State merit-based aid programs may increase support for state subsidies to students in general. Federal tax credits may also help to increase the acceptance of the federal role in subsidizing college students.

In this sense, the visibility and the political appeal of the new programs could work in favor of low-income

Figure 3.

State Need-Based and Non-Need-Based Aid in Millions of Constant (2001 Dollars), 1969–2000



Source: National Association of State Student Grant and Aid Programs, *Annual Surveys, 1994–2000*.

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students. But there is a very real danger in the message current public policy conveys. The central national goal of access to postsecondary education for all qualified students has been obscured. The federal government has created an environment in which the priority of providing educational opportunity is overshadowed by the demands of the middle class. State and institutional policies reflecting other, less efficient and less equitable priorities, have become widely accepted. A concerted national effort to reinstate the fundamental values underlying the partnership constituted to assure access to higher education regardless of ability-to-pay is a prerequisite to closing the current insurmountable gap between financial aid and college costs facing many low-income students.

Agenda

The problem of unequal educational opportunities will not be solved by expecting individuals, private organizations, educational institutions, or state governments to set aside their own interests in order to further social goals. In addition to increasing understanding of the vital equity and efficiency concerns related to reducing financial barriers to college, the solution involves understanding market forces and the role of incentives and designing federal policies to harness those forces. The federal government is responsible for setting the agenda and vigorously pursuing that agenda through its own policies and through the visible promotion of the underlying values. It must also provide incentives that will increase the level of participation of other entities in assuring access to postsecondary education for all qualified students. The need for increased funding for need-based grants at all levels should not be underemphasized, but encouraging the federal government to find efficient ways to target existing funds and generate new funds for educational opportunity from nongovernmental sources provides a more promising policy agenda in the short run.

Constructive steps towards federal strengthening of the student aid partnership would include:

1. increase the simplicity and transparency of the student aid system, linking grant levels to income;
2. substantially increase Pell Grant funding and provide a guarantee of adequate grant aid to assure access to students at public institutions with relatively high tuition levels;
3. improve the design of and increase the funding for federal matching funds to induce states, institutions, and private entities to provide more need-based subsidies to students;
4. design incentives for state policies to provide consistent funding, allowing increased access throughout the business cycle;
5. provide incentives for for-profit firms to subsidize low-income students;
6. relax the antitrust restrictions that are exacerbating the destructive competition among private colleges and diverting funds away from the students who need them most;
7. improve the terms available to students under the federally funded and guaranteed loan programs and design effective insurance policies for borrowers whose post-college incomes are inadequate for loan repayment;
8. concentrate on designing and promoting polices that clearly reflect a national agenda of increasing the equity and efficiency of higher education finance policy.

With these policy directions, the federal government can establish and solidify its role as the leader, both in terms of dollars and in terms of setting the priorities of a strong partnership that assures access to postsecondary education for all qualified students.

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